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No.89-1214

In the Supreme Court of the United States

October Term, 1989

ORTHOKINETICS, INC. and EDWARD J. GAFFNEY,
Petitioners

vs.

PENOX TECHNOLOGIES, INC. and LARRY HOHOL,
Respondents

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENTS

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COUNTERSTATEMENT OF QUESTIONS PRESENTED FOR REVIEW

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1. Whether Question No. 1 raised in the Petition for Writ of Certiorari was preserved by the Petitioners below?

2. Whether there exists no actual conflict between the Circuit Courts of Appeal regarding Question No. 1 raised in the Petition for Writ of Certiorari or no important question of federal law which has not been, but should be, settled by this Court?

3. Whether the factual nature of the dispute, the absence of a stenographic record of the arbitration hearing, and the lack of an Arbitrator's Opinion makes it inappropriate for the Supreme Court to grant a Writ of Certiorari?

4. Whether there exists no actual conflict between the Circuit Courts of Appeal regarding Question No. 2 raised in the Petition for Writ of Certiorari?

5. Whether the unclear record regarding the essential elements of Fed. R.A.P. 4(a)(5) makes it inappropriate for the Supreme Court to grant a Writ of Certiorari?

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COUNTERSTATEMENT OF THE CASE

On May 21, 1986, PENOX TECHNOLOGIES, INC., a Pennsylvania corporation ("OLD PENOX"), ORTHOKINETICS, INC, ("ORTHO"), and EDWARD J. GAFFNEY ("GAFFNEY"), entered into a patent license Agreement ("Penox Original License"). Subsequently, ORTHO, GAFFNEY, and Super Sagless Corporation ("SS") entered into a License Agreement ("SS License").

Paragraph 12 of the Penox original License provided as follows:

> In the event ORTHOKINETICS or GAFFNEY...grants a license under Letters Patent in No. 4, 007, 960 to any other party on terms more favorable than those provided herein,... PENOX shall have the option, at any time within two (2) months after receiving a copy of said license, to avail itself of such more favorable terms upon notice in writing to ORTHOKINETICS, provided that PENOX also accepts all other licensee obligations set forth in such license....

OLD PENOX timely notified ORTHO and GAFFNEY, in writing, that OLD PENOX exercised its option to avail itself of the terms of the SS License.

Paragraph 4 of the PENOX Original License provided as follows:

> ...PENOX shall pay ORTHOKINETICS a royalty on each and every reclining lift chair within the scope of... said... Patent... actually sold by PENOX... for which payment has been received by PENOX..., which royalty shall be equal to five percent (5%) of PENOX's net selling

price for such chair or $15.00 per chair, whichever is greater....

Paragraph 4 of the SS License provided as follows:

> ...SS [SUPER SAGLESS] shall pay OKI [ORTHO] an earned royalty on each and every reclining *lift chair and/or mechanisms* therefor within the scope of... said... Patent... actually sold by SS... commencing the 1st day of November, 1986 and for which the net sales price has been received by SS..., which royalty shall be equal to five percent (5%) of SS's net selling price *for such chair* or $15.00 *per chair*, whichever is greater.... [Emphasis supplied.]

Pursuant to Paragraph 4 of the SS License, SS was required to pay ORTHO an earned royalty on "each and every reclining *lift chair and/or mechanisms* therefor" sold by SS, and the amount of the royalty "shall be equal to five percent (5%) of SS's net selling price *for such chair* or $15.00 *per chair*, whichever is greater.... (Emphasis supplied.)

Notwithstanding the clear language of Paragraph 4 of the SS License, ORTHO and GAFFNEY were not charging SS a royalty equal to five percent (5%) of the net selling price for such chair or $15.00 per chair, whichever was greater. In fact, SS was charged only a royalty of five percent (5%) of the net selling price for the mechanism for the lift chair or $15.00 per mechanism, whichever was greater. In reality, the $15.00 per mechanism was greater than five percent (5%) of the net selling price for the mechanism. Moreover, when SS sold the mechanism to another company which added the chair to the mechanism and sold the finished product, the purchaser of the mechanism from SS was not charged any additional royalty because it was deemed to be an "implied licensee".

OLD PENOX argued that once it assumed the SS License, it was entitled to pay the same royalty, and to receive the same construction of the royalty terms, as ORTHO and GAFFNEY were providing to SS, ORTHO's largest and most profitable customer. OLD PENOX argued this by virtue of the "most favored licensee" clause which was contained in Paragraph 12 of the PENOX Original License and Paragraph 12 of the SS License.

When ORTHO and GAFFNEY claimed that OLD PENOX was required to pay a royalty of five percent (5%) of the net selling price of the *chair* or $15.00, whichever was greater, notwithstanding the fact that SS was charged a royalty of only five percent (5%) of the net selling price for the *mechanism* or $15.00, whichever was greater, OLD PENOX filed a Demand for Arbitration.

Paragraph 21 of the PENOX Original License and Paragraph 19 of the SS License both provided as follows:

> The parties hereto agree that if any dispute should arise as to the terms and conditions of this Agreement which cannot be resolved by the parties, that said dispute shall be resolved by submitting said dispute to the American Arbitration Association pursuant to its rules and regulations....

On September 13, 1988, a hearing was held before the arbitrator selected by the American Arbitration Association, at which time all parties appeared and participated. All parties were furnished with a full and fair opportunity to present testimony and documentary evidence. On November 7, 1988, the Arbitrator entered an award in favor of OLD PENOX, which is set forth at Petitioners' Appendix, Pg. A-32.

ORTHO and GAFFNEY filed a Petition to Vacate the Award of Arbitrator with the United States District Court for the Middle District of Pennsylvania on the basis that the Arbitrator exceeded his authority and/or committed a manifest disregard of law. OLD PENOX filed a Cross-Motion to Confirm the Award of Arbitrator.

On December 27, 1988, OLD PENOX sold substantially all of its assets, including its entire reclining chair business, to Big Ben Group, Ltd., a Missouri corporation, assignee of Essex Industries, Inc., which sale included the License Agreement, and the rights held in connection therewith, which OLD PENOX had with ORTHO and GAFFNEY, and the terms and provisions were accepted by the assignee in writing. Pursuant to the Asset Purchase Agreement, all post-closing benefits from the arbitration award in question belong to Big Ben Group, Ltd., and all pre-closing benefits were retained by OLD PENOX. The closing regarding this asset sale took place on December 27, 1988. On or about December 30, 1988, OLD PENOX changed its corporate name to LeaseCor Capital, Inc., and on December 31, 1988, LeaseCor Capital, Inc. was liquidated, and all of its assets, subject to its liabilities, were distributed to LARRY HOHOL as sole shareholder on that date.

On or about January 17, 1989, Big Ben Group, Ltd. changed its corporate name to PENOX TECHNOLOGIES, INC., a Missouri corporation ("NEW PENOX").[1] As a result, NEW PENOX and LARRY HOHOL ("HOHOL") each has an interest in the November 7, 1988 award of Arbitrator. A Motion for Substitution of Parties was filed, and the District

[1] PENOX TECHNOLOGIES, INC. is not a publicly held corporation, and has no parent company, subsidiary or affiliate corporation.

Court entered an Order substituting NEW PENOX and HOHOL as Respondents in connection with the Motion to Vacate the Arbitrator's Award, and as Petitioners in connection with the Cross-Motion to Confirm the Arbitrator's Award.

On April 18, 1989, the District Court entered a Memorandum and Order denying the Petition to Vacate the Arbitrator's Award filed by ORTHO and GAFFNEY. This same Order granted the Respondents' Cross-Motion to Confirm the Arbitrator's Award. Same is set forth at Petitioners' Appendix., Pg. A-13.

On May 16, 1989, ORTHO filed a Notice of Appeal with the United States Court of Appeals for the Third Circuit. On June 29, 1989, ORTHO and GAFFNEY filed a Motion for Enlargement of Time with the District Court within which to file a Notice of Appeal and to Conform the Caption to include GAFFNEY as an Appellant. The District Court, without opinion, granted the aforementioned Motion on July 5, 1989. On July 14, 1989, NEW PENOX and HOHOL filed a Motion for Reconsideration of the Court's Order granting GAFFNEY's Motion for Enlargement of Time, which was denied.

On November 3, 1989, the Court of Appeals for the Third Circuit affirmed the decision of the District Court because: (a) on the merits, the arbitrator did not exceed his authority or commit a manifest disregard of law, and (b) in any event, GAFFNEY had failed to timely appeal the District Court's ruling. Same is set forth at Petitioners' Appendix, Pg. A-1.

SUMMARY OF ARGUMENT

Just as in the labor field, there exists a strong federal policy favoring commercial arbitrations. *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S.Ct. 2332, 96 L.Ed. 2d 185 (1987) *reh. den.* 483 U.S. 1056, 108 S.Ct, 31, 97 L.Ed. 2d 819 (1987). This federal policy is a pervasive one which ought not to be lightly overridden. The basic policy of the Federal Arbitration Act is to promote the speedy disposition of disputes without the expense and delay of protracted court proceedings.

The decision of the Court of Appeals in the instant matter was in accord with the decisions of the Supreme Court of the United States regarding the standard of review in labor arbitration cases. The Petitioners submitted these labor cases to the Court below and should not be heard to complain when the Court of Appeals relied on them. Moreover, the Arbitrator's determination turned on the facts developed before him, and there does not exist any transcript of the hearing as neither party requested one. There exists no special and important reason for this Court to hear this matter, especially because the necessity of an intense factual analysis makes this a case of little significance to anyone except the litigants.

In addition, regarding the second issue raised by Petitioners, the alleged conflict in the Circuits arises from the Petitioners' inability or unwillingness to distinguish between holding and dicta. Upon careful analysis, the holdings of the cases cited by Petitioners are entirely consistent.

In summary, while this case is obviously important to the parties, there is lacking any element of national significance or importance which should detract from or interfere with this

Court's ability to consider and resolve the more important issues confronting our nation.

QUESTION NO. 1

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1. The Position Taken By Petitioners In Requesting The Supreme Court To Grant A Writ Of Certiorari Is Inconsistent With The Position Taken By Them In The Court Below

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There exists no reason, much less a special and important reason, for this Honorable Court to grant a Writ of Certiorari in this matter. Supreme Court Rule 17 provides that:

> A review on writ of certiorari is not a matter of right, but of judicial discretion, and will be granted only when there are *special and important reasons* therefor [emphasis added].

It further provides that the following factors, while neither controlling nor fully measuring the Court's discretion, indicate the character of the reasons that will be considered:

> (a) When a federal court of appeals has rendered a decision in conflict with the decision of another federal court of appeals on the same matter; or has decided a federal question in a way in conflict with a state court of last resort; or has so far departed from the accepted and usual course of judicial proceedings, or so far sanctioned such a departure by a lower court, as to call for an exercise of this Court's power of supervision.
>
> (b) When a state court of last resort has decided a federal question in a way in conflict with the decision of

another state court of last resort or of a federal court of appeals.

(c) When a state court or a federal court of appeals has decided an important question of federal law which has not been, but should be, settled by this Court, or has decided a federal question in a way in conflict with applicable decisions of this Court.

Regarding the first question raised for review by the Petitioners, while the Petition is vague, the only basis submitted by Petitioners in support of an appeal appears to be that the standard of review of commercial arbitration proceedings under the Federal Arbitration Act must be clarified. (Page 8 of Petition for Writ of Certiorari.) Petitioners contend that it is not clear whether this Court's precedents in labor arbitration cases define the standard of review for proceedings to vacate commercial arbitration awards under the Federal Arbitration Act. Petitioners did not raise this issue in the Court below. To the contrary, the Petitioners cited labor arbitration cases to the Court below as the standard of review. (See the attached Appendix.) Both the District Court and the Court of Appeals followed labor arbitration cases in denying the Motion to Vacate and in granting the Motion to Confirm the Arbitrator's Award. Significantly, the Petitioners on page 9 of their Brief with the Court of Appeals stated, "although the District Court examined the appropriate authorities it did not follow the applicable law set forth therein." In addition, the Petitioners referred the Court of Appeals to this Court's opinion in *United Steelworkers of America v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 80 S.Ct. 1358, 4 L.Ed. 2d 1424 (1960), and stated in their Brief that:

> The [arbitrator's] award is legitimate only so long as it draws its essence from the agreement. When the award

is not based on the agreement, the Courts have no choice but to refuse to enforce the award, *United Steelworkers of America v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 80 S.Ct. 1358 (1960).

It is clear that this Court will refrain from addressing issues not raised or presented in the Court of Appeals. *EEOC v. Federal Labor Relations Authority*, 476 U.S. 19, 90 L.Ed. 2d 19, 106 S.Ct. 1678 (1986). Before the Court of Appeals, the Petitioners referred the Court to labor cases as setting the standard for review, and as noted above, stated that the District Court had examined "the appropriate authorities." Given such statements and actions by Petitioners below, it is submitted that there are no special and important reasons for this Honorable Court to grant review on a Writ of Certiorari. The issue was neither properly preserved by the Petitioners nor fully developed before the Court of Appeals. Accordingly, the Petition for Writ of Certiorari should be denied.

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2. There Exists No Actual Conflict Or Inconsistency Between The Circuit Courts Nor Is There An Important Question Of Federal Law Which Has Not Been, But Should Be, Settled By This Court

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Assuming *arguendo* that the Petitioners properly preserved for review the issue they raise regarding the applicability of the labor standard of review to a commercial arbitration case, there exists no actual conflict among the Circuit Courts nor an important question of federal law which has not been, but should be, settled by this Court.

Before the Court of Appeals, Petitioners relied upon *United Steelworkers of America v. Enterprise Wheel & Car*

Corporation, supra, and its progeny, as the standard of review for the instant matter. An analysis of the opinion of the Court of Appeals for the Third Circuit shows that that court followed well-established principles of the United States Supreme Court which have been widely recognized in the other Circuit Courts of Appeal.

The Court of Appeals determined that the district court confirmed the Arbitrator's award because:

> ... [Petitioners] had failed to show that the award was fundamentally irrational or failed to draw its essence from the parties' agreement. [Petitioners' Appendix at A-12.]

The Court of Appeals further determined:

> We also do not find that the arbitrator's award was irrational or failed to draw its essence from the royalty agreement at issue. [Petitioners' Appendix at A-12.]

Additionally, the Court of Appeals ruled that:

> The arbitrator could have determined from the testimony of the parties that the most favored licensee agreement would have little meaning if the term is [sic] used to calculate the product was different. ...Thus, the arbitrator was giving meaning to the intent behind the clause, rather than an illusory written interpretation. [Petitioners' Appendix at A-12.]

In *United Paperworkers International Union, AFL-CIO v. Misco, Inc.*, 484 U.S. 29, 108 S.Ct. 364, 98 L.Ed. 2d 286 (1987), a case involving several aspects of when a federal court may refuse to enforce arbitration awards under a collective bargaining agreement on the basis of *public policy*, the Court reaffirmed the *Enterprise Wheel* standard, stating:

> As the Court has said, the arbitrator's award settling a dispute with respect to the interpretation or application

> of a labor agreement must draw its essence from the contract and cannot simply reflect the arbitrator's own notions of industrial justice. But as long as the arbitrator is even arguably construing or applying the contract and acting within the scope of his authority, that a court is convinced he committed serious error does not suffice to overturn his decision.

98 L.Ed. 2d at 299.

Petitioners, in their brief, correctly recognize that *Enterprise Wheel* and *Misco* both promote use of the "essence" test. Both the District Court and Court of Appeals for the Third Circuit determined that the Arbitrator had construed and applied the contract terms, and as such, did not exceed his authority. As such, the opinion of the Court below is entirely consistent with this Court's opinion in *Misco*.[2] It is clear that *Misco* reaffirmed the "essence" test, as was pronounced in *Enterprise Wheel*, and the Court below utilized precisely that test. Both of the lower courts believed that the Arbitrator's decision was not irrational, in other words, that his award was an arguable construction and application of the contract. This was especially so where the applicable contract contained a most favored licensee clause, as was the case here.

The decision of the Court of Appeals for the Third Circuit is in accord with the decisions of the Supreme Court of the United States and rulings throughout the various Circuit Courts regarding the standard of review for proceedings to

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[2] It is also interesting to note that while the Petitioners contend in their Petition that "[T]he Third Circuit ignored *Misco*, although it was cited ... by Petitioners" [See Pg. 21 of Petition for Writ of Certiorari], the Petitioners' only reference to *Misco* in their Brief below was one isolated reference within a quote from an 8th Circuit opinion, *Inter-City Gas Corp. v. Boise Cascade Corp.*, 845 F.2d 184 (8th Cir. 1988). [See Petitioners' Brief below at Pg. 15.]

vacate arbitration awards. *Enterprise Wheel* established a broad test as to whether the Arbitrator's award "draws its essence" from the agreement of the parties. The various Circuit Courts have interpreted the ruling of *Enterprise Wheel* and consistently list uniform criteria to determine whether an arbitration award is subject to vacation.

In *Enterprise Wheel,* the Court held that:

> Nevertheless, an arbitrator is confined to interpretation and application of the ... agreement; he does not sit to dispense his own brand of industrial justice. He may of course look for guidance from many sources, yet his award is legitimate only so long as it draws its essence from the ... agreement.

4 L.Ed. 2d at 1428.

In *Misco,* the Court held:

> ...the arbitrator's award settling a dispute with respect to the interpretation or application of a labor agreement must draw its essence from the contract and cannot simply reflect the arbitrator's own notions of industrial justice. But as long as the arbitrator is *even arguably construing or applying the contract* and acting within the scope of his authority, that a court is convinced he committed serious error does not suffice to overturn his decision [emphasis supplied].

98 L.Ed. 2d at 299.

The Third Circuit, in accord with *Misco* and *Enterprise Wheel,* recognized the duty of the arbitrator to interpret and apply the terms contained in the agreement itself.

The various Circuit Courts are consistent in reviewing arbitration awards to determine if grounds for vacating an

award are present. Some Circuits have adopted the "rational" test, that:

> 'An arbitrator's award does "draw its essence from the ... agreement" so long as the interpretation can in some rational manner be derived from the agreement, "viewed in the light of its language, its context and any other indicia of the parties' intention ...." '

Tootsie Roll Industries, Inc. v. Local Union, No. 1, Bakery, Confectionery and Tobacco Workers' International Union, 832 F.2d 81, 83 (7th Cir. 1987).

> An award fails to derive its essence from the agreement when (1) an award conflicts with express terms of the collective bargaining agreement [citation omitted]; (2) an award imposes additional requirements that are not expressly provided in the agreement [citation omitted]; (3) an award is without rational support or cannot be rationally derived from the terms of the agreement [citation omitted]; and (4) an award is based on general considerations of fairness and equity instead of the precise terms of the agreement [citation omitted].

Cement Division, National Gypsum Co. v. United Steel Workers of America, AFL-CIO-CLC, Local 135, 793 F.2d 759, 766 (6th Cir. 1986), *citing Timken Co. v. United Steel Workers of America*, 482 F.2d 1012 (6th Cir. 1973).

> ...'[A]s long as arbitrators remain within their jurisdiction and do not reach an irrational result, they may "fashion the law to fit the facts before them" and their award will not be set aside because they erred in the determination or application of the law ... .'

I/S Stavborg v. National Metal Converters, Inc., 500 F.2d 424, 431 (2d Cir. 1974) *citing Marcy Lee Manufacturing Co. v. Cortley Fabrics Co.*, 354 F.2d 42 (2d Cir. 1965).

Still other Circuit Courts have attempted to delineate factors useful in determining whether an award "draws its essence" from the agreement of the parties. As stated in *Pack Concrete, Inc. v. Cunningham and Teamsters Local No. 2*, 866 F.2d 283, 285 (9th Cir. 1989):

> The scope of review of an arbitrator's decision is extremely narrow. [Citations omitted]. 'As long as the arbitrator's award "draws its essence from the ... agreement" and is not merely "his own brand of industrial justice," the award is legitimate.' [Citations omitted]. "[I]f on its face, the award represents a plausible interpretation of the contract, judicial inquiry ceases and the award must be enforced." [Citations omitted].

In *United Food and Commercial Workers Local Union No. 7R v. Safeway Stores, Inc. and Cortez*, 889 F.2d 940, 946-947 (10th Cir. 1989), the Court stated:

> '[W]here the question of the submission to the arbitrator is vague, the award of the arbitrator will not be set aside in a subsequent court proceeding, unless it can be shown that the essence of the resulting award was not drawn from the collective bargaining agreement.' [Citations omitted.] The parties may limit the discretion of the arbitrator, such as through submitting a precise statement of the issues to the arbitrator or through providing express limitations in the collective bargaining agreement. [Citation omitted.] When the parties fail to limit the scope of the submission, however, we will affirm the arbitrator's award if it draws its essence from the ... agreement and

> is not contrary to the express language of that agreement. [Citations omitted.]
>
> We will not interfere with an arbitrator's decision 'unless it can be said with positive assurance that the contract is not susceptible to the arbitrator's interpretation.' [Citations omitted.] '[A]s long as the arbitrator is even arguably construing or applying the contract and acting within the scope of his authority, that a court is convinced he committed serious error does not suffice to overturn his decision.' [Citation omitted.]

Regardless of the specific criteria considered by the Circuit Courts, the tests as pronounced by the Circuit Courts require the reviewing court to make a careful analysis of the agreement between the parties and a determination as to whether the Arbitrator arguably construed or applied the contract in arriving at his or her determination. As aptly stated in *Enterprise Wheel:*

> There the need is for flexibility in meeting a wide variety of situations. The draftsmen may never have thought of what specific remedy should be awarded to meet a particular contingency.

4 L.Ed. 2d at 1428.

The District Court and the Court of Appeals for the Third Circuit determined that the award herein was not fundamentally irrational nor did it fail to draw its essence from the parties' agreement. The decision of the Third Circuit was in accordance with the decisions of the Supreme Court of the United States, its own precedents, and rulings throughout the Circuit Courts of Appeal regarding the standards to be applied. As such, there exists neither a conflict between the Circuit Courts, nor an important question of federal law which

has not been, but should be, settled by this Court. Due to the uniformity of the decisions among the various Circuit Courts and this Court, as well as the inconsistency in the position taken first by the Petitioners below and now here, the Petition for Writ of Certiorari should be denied.

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3. The Petition For Writ Of Certiorari Should Be Denied Because The Arbitrator's Determination Was Based Upon The Facts Presented To Him, And There Is No Adequate Or Clear Record Of The Arbitration Hearing

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The Court of Appeals for the Third Circuit noted in the instant matter, "although our review is made more difficult since the arbitrator did not write an opinion to explain his interpretation, it is obviously not for us to rewrite the contract, but rather, to determine whether the contract will support the arbitrator's interpretation." Petitioners' Appendix at A-11. The Court may dismiss a Petition for Writ of Certiorari where the record is unclear or obscure. *Taggert v. Weinacker's, Inc.*, 397 U.S. 223, 90 S.Ct. 876, 25 L.Ed. 2d 240 (1970). Neither the District Court nor the Court of Appeals could say that the Arbitrator was not arguably construing or applying the license agreement in arriving at his determination. The arbitration hearing turned upon the facts presented there, construed in light of and in conjunction with the most favored licensee clause of the contract. While either party had the right to request a stenographic record pursuant to the rules of the American Arbitration Association, no party made such a request. Without any stenographic record or opinion, the Respondents submit that the Court should deny the Petition for Writ of Certiorari.

Additionally, even it the Court could recreate the factual record by affidavits, the Court should nonetheless deny the Petition for Writ of Certiorari as the Arbitrator's determination turned upon factual questions. Where an issue for which the Court granted certiorari turned upon certain factual questions, the Writ was dismissed as improvidently granted since a review of the findings of fact would be of no importance except to the litigants themselves. *Rudolph v. United States,* 370 U.S. 269, 82 S.Ct. 1277, 8 L.Ed. 2d 484 (1962), *reh. den.* 371 U.S. 854, 83 S.Ct. 15, 9 L.Ed. 2d 93 (1962).

For the foregoing reasons, the Petition for Writ of Certiorari should be denied.

QUESTION NO. 2

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4. The Petition For Writ Of Certiorari Should Be Denied Because There Exists No Actual Conflict Between The Circuit Courts Of Appeal

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The Petitioners' only basis for this Court's exercising its discretion to grant review on a writ of certiorari regarding Question No. 2 is the contention that a conflict exists between one decision from the Court of Appeals for the Second Circuit and one decision from the Court of Appeals for the Third Circuit. The Petitioners do not refer the Court to any decision from any other circuit which even addresses this issue. A careful analysis of the two decisions cited by Petitioners discloses that no actual conflict exists between the holdings of these decisions, and the alleged conflict is nothing more than Petitioners' failure to distinguish between holding and dicta.

Petitioners contend that the ruling in *Melton v. Frank*, 891 F.2d 1054 (2d Cir. 1989), conflicts with the ruling entered by the Third Circuit in the instant matter which held that the failure of Petitioner, GAFFNEY, to file a timely Notice of Appeal or Motion for Enlargement of Time to Appeal constituted a jurisdictional bar to the appeal. The Court also held that upon the timely filing of a Notice of Appeal by the Petitioner, ORTHO, jurisdiction over the case was immediately transferred from the district court to the Court of Appeals, and an untimely Motion for Enlargement of Time did not present an instance in which the district court retained power to act.

The Court in *Melton* similarly held that an appeal would be dismissed for lack of appellate jurisdiction where there was a 106 day delay between the entry of final judgment and the filing of a *pro se* Motion to Extend the Time to File a Notice of Appeal. As such, the holding of the Court of Appeals for the Second Circuit in *Melton* is consistent with the holding of the Court of Appeals for the Third Circuit in the instant matter.

Petitioners are incorrect when they state that the holding of the Second Circuit in *Melton* was that "a Motion for Extension of Time for a Cross Appeal would be timely if filed within 104 days ... because of the automatic fourteen day extension following a timely filed first Notice of Appeal to an 'other party' under Rule 4(a)(3) and the 30 days afforded under Rule 4(a)(5)." Instead, the Court in *Melton* held that the appeal should be dismissed due to the absence of appellate jurisdiction because of the failure of the appellant to file a timely Notice of Appeal or Motion for Extension of Time to Appeal. Rather than referring this Court to the holding in *Melton*, Petitioners are looking to dictum in the Second Circuit's

opinion in a futile and transparent attempt to manufacture an inconsistency between the Circuit Courts of Appeal.

Any reference by the Second Circuit as to whether the time for filing a Motion for Enlargement of Time under Fed. R.A.P. 4(a)(5) runs from the time set forth in Fed. R.A.P. 4(a)(1) or from the combined time of Fed. R.A.P. 4(a)(1) and 4(a)(3) was totally unnecessary to its decision. This is so because the Second Circuit concluded that the Motion for Enlargement of Time was filed more than thirty (30) days after the expiration of either of such time periods. Accordingly, the reference by the Second Circuit, which Petitioners claim is inconsistent with the opinion of the Third Circuit, was unnecessary and surplusage. Respondents respectfully submit that this Honorable Court has more important and more pressing demands upon its limited time and resources than to consider an alleged inconsistency between the holding of one case and dicta in another.

Dictum is the part of an opinion that a later court, even if it is an inferior court, is free to reject. Dictum has been defined as:

> 'a statement in a judicial opinion that could have been deleted without seriously impairing the analytical foundations of the holding—that, being peripheral, may not have received the full and careful consideration of the court that uttered it.' [Citation omitted.] '[D]ictum is a general argument or observation unnecessary to the decision.... The basic formula [for distinguishing holding from dictum] is to take account of facts treated by the judge as material and determine whether the contested opinion is based upon them.' [Citation omitted.] A dictum is 'any statement made by a court for use in argument, illustration, analogy or suggestion. It is a remark,

> an aside, concerning some rule of law or legal proposition that is not necessarily essential to the decision and lacks the authority of adjudication.' [Citation omitted.] It is 'a statement not addressed to the question before the court or necessary for its decision.' [Citation omitted.]

United States v. Crawley, 837 F.2d 291, 292 (7th Cir. 1988). Dictum is unnecessary to the decision in a case and is, therefore, not controlling in a subsequent case. *McDaniel v. Sanchez*, 452 U.S. 130, 68 L.Ed. 2d 724, 734, 101 S.Ct. 2224 (1981).

As stated by Chief Justice Marshall nearly 170 years ago:

> 'It is a maxim not to be disregarded, that general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used. If they go beyond the case, they may be respected, but ought not to control the judgment in a subsequent suit when the very point is presented for decision. The reason of this maxim is obvious. The question actually before the court is investigated with care and considered in its full extent. Other principles which may serve to illustrate it, are considered in their relation to the case decided, but their possible bearing on all other cases is seldom completely investigated.'

Cohens v. Virginia, 6 Wheat. 264, 399-400, 19 U.S. 264, 5 L.Ed. 257, 290 (1821), quoted in *U.S. v. Vignola*, 464 F. Supp. 1091, 1099 n.25 (E.D. Pa. 1979), *aff'd without op.* 605 F.2d 1199 (3rd Cir. 1979), *cert. den.* 444 U.S. 1072, 100 S.Ct. 1015, 62 L.Ed. 2d 753 (1979).

In *Melton*, as noted above, the Court determined that the Motion for Extension of Time to Appeal was filed outside the time limits set forth in Fed. R.A.P. 4(a)(5), regardless of

whether or not the 14 day extension of time permitted by Fed. R.A.P. 4(a)(3) was added to the time permitted to appeal by Fed. R.A.P. 4(a)(1). The Court's statement dealing with the computation of time under Fed. R.A.P. 4(a)(1) and 4(a)(3) constituted dictum. The holding in *Melton* is entirely consistent with the Third Circuit's holding in the instant matter.

The Respondents respectfully submit that the Court should exercise its discretion to deny the Petition for Writ of Certiorari as there is no direct conflict between the holdings of the two cases cited by Petitioners.

In addition, inasmuch as Petitioners are able to cite the Court to only a single decision (dicta) in one other Circuit regarding this issue, Respondents submit that the Court should allow the Courts of Appeals for the other Circuits time to consider this issue before deciding whether a true conflict exists in the Circuits which presents this Court with a special and important reason to exercise its discretion to expend its valuable time in order to resolve such conflict. Consideration at this time would be premature.

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5. The Petition For Writ Of Certiorari Should Be Denied Because The Record Regarding "Excusable Neglect Or Good Cause" Under Fed. R.A.P. 4(a)(5) Is Unclear

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According to Fed. R.A.P. 4(a)(5):

> The district court, upon a showing of excusable neglect or good cause, may extend the time for filing a notice of appeal upon motion filed not later than 30 days after the expiration of the time prescribed by this Rule 4(a).

In the instant case, the Third Circuit did not address the question of "excusable neglect or good cause" pursuant to Fed. R.A.P. 4(a)(5) because of its disposition of the untimeliness issue. Moreover, a review of the record before the District Court will disclose that there existed absolutely no factual basis for a finding of "excusable neglect or good cause." There were no depositions or affidavits filed by Petitioners to properly create such a factual record. Moreover, the District Court did not write an opinion regarding its disposition of the Motion for Enlargement of Time to Appeal. Significantly, a review of the Petition for Writ of Certiorari discloses that the Petitioners never explain the factual basis for a finding of "excusable neglect or good cause." As noted above, this Court may dismiss a Petition for Writ of Certiorari where the record is unclear or obscure. *Taggert v. Weinacker's, Inc., supra.* There is lacking any record for this Court to find an essential element regarding the basis for an extension of the time to appeal, and the Petition for Writ of Certiorari should be denied.

CONCLUSION

For these reasons, the Petition for Writ of Certiorari filed by ORTHO and GAFFNEY should he denied.

Respectfully submitted,
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APPENDIX

BRIEF OF APPELLANTS

IN THE

United States Court of Appeals

FOR THE THIRD CIRCUIT
Appeal No. 89-5417
Orthokinetics, Inc. and,
Edward J. Gaffney,
Appellants
- vs -
Penox Technologies, Inc. and
Larry Hohol,
Appellees,
On Appeal From a Decision of the United States District Court for the Middle District of Pennsylvania
(Judge William J. Nealon, Jr.)

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STATEMENT OF JURISDICTION

The District Court had jurisdiction of the Motion to Vacate and the Cross Motion to Confirm the arbitration award under Title 9, Section 9, and Sections 10 and 11. The arbitration clause in the contract between the parties provides that the American Arbitration Rules would govern. Rule 40(b) of the AAA rules (App. 13) provides that judgment can be entered on the award in any Court. This meets the jurisdictional requirements of 9 USC Section 9. The District Court also had diversity jurisdiction. This Court has jurisdiction of this case under 28 USC Section 1291 because the order for judgment of the Court below was a final order or decision. The District Court denied appellant's motion to vacate and entered judgment confirming the award.

STATEMENT OF ISSUES PRESENTED FOR REVIEW AND STANDARD OF REVIEW

1. Did Orthokinetics establish the statutory ground to vacate the award under 9 U.S.C. §10(d) that the arbitrator exceeded his power by rewriting the royalty terms and amending the agreement?

Standard of Review: The Standard of Review is plenary under 9 U.S.C. §10(d) and this Court:

(a) can independently determine if Orthokinetics established grounds to vacate the award under this statute. This Court is in the same position as the District Court when it comes to reviewing an arbitration award, *Moseley, Hallgarten, Estabrook & Weeden v. Ellis*, 849 F.2d 264 (7th Cir. 1988), at

page 267; *Mutual Fire, Marine & Inland v. Norad Reinsurance,* 868 F.2d 52 (3d Cir. 1989), at page 56.

(b) In addition, this Court can vacate the award if the arbitrator "manifest[s] an infidelity" to her obligation to interpret the contract, *United Steelworkers of America v. Enterprise Wheel & Car Corp.,* 363 U.S. 593, 597, 80 S.Ct, 1358, 1361, 4 L.Ed.2d 1424 (1960), ignores a plain and unambiguous provision of the contract, see *NF & M Corp. v. United Steelworkers of America,* 524 F.2d 756, 759 (3d Cir. 1975); *Apex Fountain Sales, Inc. v. Kleinfeld,* 818 F.2d 1089 (3d Cir. 1987); if the interpretation of the arbitrator cannot in any rational way be derived from the agreement, viewed in the light of its language, its context, and any other indicia of the parties' intention; where there is a manifest disregard of the agreement by the arbitrator, totally unsupported by principles of contract construction. *Ludwig Honold Mfg. Co. v. Fletcher,* 405 F.2d 1123, 1128, (3d Cir. 1969); *Graphic Arts Intern. Union v. Haddon Craftsmen,* 796 F.2d 692 (3d Cir. 1986).

(c) A commercial arbitration award review is not as limited as labor arbitration review. *Swift Industries, Inc. v. Botany Industries, Inc.,* 466 F.2d 1125 (3d Cir. 1972).

2. Should the award be vacated because the arbitrator exceeded his power as limited by 9 USC §10(d) by amending unambiguous royalty provisions which awarded Penox a different royalty than Super Sagless under the same royalty provisions?

Standard of Review: Same as Issue 1 above.

3. Should the award be vacated because the result is irrational where Penox adopts the Super Sagless royalty terms and the arbitrator changes the terms so that Penox, a manufacturer of a complete chair, will always pay the minimum

royalty of $15.00 and never pay a 5% royalty on a chair, whereas subcontractor, Super Sagless, under the same royalty provision, will be required to pay 5%, a greater amount, if it sells a chair rather than a base?

Standard of Review: Same as Issue 1 above.

4. Did the District Court err in construing the award as a permissible interpretation of ambiguous language in the contract rather than a re-writing of the contract beyond the power of an arbitrator, and base its decision on cases giving arbitrators broad powers to interpret rather than basing its decision on 9 USC §10(d) which limits the power of the arbitrator to re-write agreements?

Standard of Review: Same as Issue 1 above.

STATEMENT OF THE CASE

This is an Appeal of a decision confirming an arbitration award and denying a Motion to Vacate the Award in American Arbitration Association Case No. 14 133 0109 88 B/E LU Penox Technologies, Inc. and Orthokinetics, Inc. and Edward J. Gaffney. The arbitration related to a patent license which was part of a settlement in a patent infringement suit commenced by the owners of the Patent Orthokinetics, Inc. and Edward J. Gaffney against the infringers Penox Technologies, Inc., Larry Hohol, Edward Stanks and Joel F. Guerrin, CV-85-1697, in the United States District Court for the Middle District of Pennsylvania, App. 107). The patent infringement action was settled with a consent decree of dismissal with prejudice and a patent license granted by Plaintiff, Orthokinetics and Edward Gaffney to Penox for the patent-in-suit U.S. Patent 4,007,960 (App. 113). The license granted to Penox the

right to continue to manufacture recliner lift chairs, which were the subject of the patent infringement suit, and pay a royalty under the terms and conditions of the patent license. The patent license contained a most favored nation clause and pursuant to that clause, Penox adopted the terms of a subsequent patent license granted to a Mississippi company, Super Sagless, App. 139. Penox sought arbitration to change the license agreement adopted from Super Sagless so that Penox would only have to pay a $15.00 per chair royalty no matter what product was sold — a base or a chair not 5% or $15.00 per chair whichever is greater. The arbitrator made an award changing the adopted Penox license terms to require a royalty from Penox only on the base and also awarded damages to Penox of $32,123.13 for royalties based on the prior Penox agreement which Penox contended it over-paid. Penox's demand for arbitration sought damages in the amount of $55,298.53, App. 100. Orthokinetics filed a Petition or Motion to Vacate the award (App. 21) on the ground among other matters that Penox does not make and sell chair bases separately but incorporates bases made by another company in complete chairs (Petition, App. 26, 29). The District Court denied the Motion to Vacate the award and ordered judgment confirming the award (App. 260). The Appeal is from the judgment.

STATEMENT OF RELATED CASES AND PROCEEDINGS

The patent involved in this suit was involved in three other patent infringement suits in Pennsylvania. All were settled with the grant of a license. There are no cases pending involving arbitration of a patent license.

STATEMENT OF FACTS

Edward Gaffney is the President and founder of Orthokinetics and inventor of the patent subject to the Penox License. Orthokinetics was founded to market to the public an elevator or lift chair which Gaffney had invented for which he obtained a patent. He obtained several patents on elevator lift chairs including the Patent 4,007,960 (Exhibit 4, App. 113), which is the subject of the patent license in this proceeding. Prior to November 22, 1985, Penox was charged with infringement of the patent. Penox refused to stop the infringement and Orthokinetics and Gaffney commenced a suit on November 22, 1985 for patent infringement against Penox and various officers including Joel F. Guerrin (App. 107). Joel F. Guerrin was Executive Vice President, who testified as a witness at the arbitration hearing. There was no transcript made of the hearing or proceedings. However, there is no dispute of the facts which are contained in various exhibits and briefs in the appendix. The complaint, paragraph 16, (App. 110) alleged willful infringement by the officers and Penox. Subsequent to the commencement of the suit and on or about May 21, 1986, the suit was settled by Consent Decree (Exhibit 6, App. 136), which resulted in a final resolution of the allegations in the complaint by dismissing the suit with prejudice against Penox. The Consent Decree was signed on June 9, 1986, App. 138. The patent license which is in dispute (Exhibit 5, App. 124) resulted from negotiations which started in January 1986 by a letter (Exhibit 9, App. 151).

Subsequently, and after settlement of the Penox suit, Super Sagless (SS) of Tupelo, Mississippi contacted Orthokinetics and requested a license so that SS could make

bases for lift chairs, the bases being generally of the type shown in Fig. 4 of the Orthokinetics patent, App. 115. SS also wanted the right in the license to make chairs. The bases constitute the supporting metal framework which contacts the floor. The base includes links and motor actuators which move an upholstered chair frame between reclining and lift positions as shown in the patent. The license to Super Sagless was executed by Super Sagless on May 6, 1987 but became effective as of December 24, 1986, Exhibit 7 (App. 139). This license contained the same royalty provision of 5% or $15 per chair, whichever is greater (App. 140), as in the Penox license, App, 126. The Penox license contained a *most favored nation* or *most favored licensee clause* which enabled Penox to adopt the terms in subsequent licenses which were more favorable.

Orthokinetics informed Penox about the Super Sagless agreement. After obtaining a copy of the Super Sagless license, Penox's patent attorney sent a letter dated January 27, 1988, Exhibit 17 (App. 186), to attorney Henry Fuller, attorney for Orthokinetics. The letter indicated that Penox would adopt the SS agreement. The attorney for Penox admitted in the January 27 letter (App. 186) that the literal wording of the royalty provision in the SS agreement is the same as the comparable language relating to the royalty in the Penox agreement (App. 186). Penox, however, complained that the practical effect of the license resulted in different royalty payments between Penox and Super Sagless because SS primarily sold bases for under $100 (one hundred dollars) and paid a royalty of $15.00 per base. Penox sold chairs, not bases, which chairs had an average price of $397.00, and was paying a 5% royalty.

By letter of January 28, 1988, Exhibit 18 (App. 190), Penox elected under the Most Favored Nations clause, Para-

graph 12 of the Penox license (Exhibit 5, App. 129), the terms of the Super Sagless license.

Penox License—Most Favored Nation Clause

The most favored nation clause under which Penox adopted the Super Sagless provisions provides in part as follows:

> "12. In the event ORTHOKINETICS or GAFFNEY hereafter grants a license under Letters Patent No. 4,007,960 to any other party on terms more favorable than those provided herein, ORTHOKINETICS or GAFFNEY, whichever has granted the license, shall promptly notify PENOX of the granting of such a license and shall provide PENOX with a copy thereof, and PENOX shall have the option, at any time within two (2) months after receiving a copy of said license, to avail itself of such more favorable terms ***" (App. 129)

Although Penox adopted the Super Sagless (SS) license pursuant to the most favored nation clause in the Penox license, Penox did not comply with the royalty specified in the adopted Super Sagless license:

> "which royalty shall be equal to five per cent (5%) *of SS's net selling price for such chair* or $15.00 per chair whichever is greater." App. 140.

Penox does not make and sell bases. Super Sagless (SS) is a sub contractor which primarily sells bases, not chairs. Penox is a manufacturer which sells complete chairs which incorporate bases made for Penox by a local supplier. Because the average sales price of the Penox chairs between 1986 and 1988 is $397.05 the royalty provision of 5% of $397.05 has

applied to Penox with a resulting average royalty of $19.85 per chair. The minimum royalty of $15.00 a chair has not applied because the royalty of $19.85 is the greater of $15.00 or 5% when applied to the chair sales price of $397.05.

Under the same royalty provision, Super Sagless was selling bases for $95.31 and hence the $15.00 royalty was the greater of 5% or $15.00 as applied to $95.31, App. 204. However, Penox initially refused to pay the royalty due under the 5% or $15.00 of the adopted Super Sagless license provisions, and recomputed the past royalties paid, shown on the attachment to Exhibit 2, page 0105 to pay only $15 per chair which incorporated the base, rather than 5%. As a result of Penox's failure to pay the full royalties due under the terms of the Penux or Super Sagless license, Orthokinetics gave notice of termination of the license by letter of February 19, 1988, Exhibit 23, App. 198. Prior to expiration of the 60 days notice of termination, Penox paid the royalty deficiency under protest with a letter of transmittal, Exhibit 23, and a check for $51,477 attached thereto, App. 198. The amounts paid under protest consisted of the sums which, in the arbitration, Penox contended should be repaid to Penox, as well as past royalties paid at the rate of 5% not $15.00. The arbitration was initiated in March, 1988 by Penox by the filing of the arbitration demand (App. 100).

Summary of Argument

Orthokinetics has established the grounds to vacate the award under 9 USC §10(d) in that the arbitrator exceeded his power and amended and rewrote the agreement. Orthokinetics has also established the judicially created ground for vacat-

ing the award under 9 USC §10(d) in that the award is not rationally based on the agreement.

This Court is in the same position as the District Court to determine whether Orthokinetics has met the statutory requirements to vacate the award on these grounds, *Moseley, Hallgarten, Estabrook & Weeden v. Ellis*, 849 F.2d 264 (7th Cir. 1988), at page 267; *Mutual Fire Marine & Inland v. Norad Reinsurance*, 868 F.2d 52 (3d Cir. 1989), at page 56.

The arbitrator's award should be vacated because it disregarded the plain unambiguous royalty provisions, which constitutes a re-writing of the agreement, *Inter-City Gas Corp. v. Boise Cascade Corp.*, 845 F.2d 184 (8th Cir. 1988).

This is not a case where there is a dispute as to the interpretation of an ambiguous term in the agreement. The royalty provision is unambiguous and neither party has urged a different interpretation of the same contract terms. Penox admitted that the terms are the same for Penox and SS. They have to be. *Penox adopted the SS terms*. Then Penox got the notion that it wanted the SS terms changed so the word "chair" would mean "base". But as far as SS is concerned, "chair" would still mean chair. The arbitrator's modification of the terms in accordance with Penox's request is not an interpretation of the agreement, but, rather, it is an amendment or re-writing of the original agreement.

The issue is not whether the arbitrator correctly interpreted the agreement. The issue is whether he had the power to rewrite the agreement. The law is clear that neither a Court nor an arbitrator can rewrite the unambiguous terms of an agreement.

The District Court erred in its analysis of the issue and relied on cases which give broad powers to arbitrators to

interpret agreements (See Add. 10, App. 254) rather than case law which prohibits the amendment of contracts by arbitrators.

In addition, the award is not rationally based on the agreement and should be set aside because it results in lower royalty payments for Penox than Super Sagless, even though both parties operate under the same royalty provisions. The most favored licensee clause only affords Penox the same or equal royalty terms, not different and lower royalties than the subsequent licensee, SS, from the license terms that were adopted. The Penox and SS licenses, before being modified by the arbitrator, are consistent with the philosophy of the applicable patent statutes and the intent of the parties that direct infringers of the entire chair (Penox) covered by the claims pay a higher royalty than a subcontractor (SS) who sells only part of the patented subject matter. The award, which amended the contract, effectively removes the 5% royalty from the contract and Penox will pay $15.00 if it sells a base and $15.00 if it sells a chair incorporating a base. Thus, the award is not rationally based on the agreement and should be set aside because it not only allows Penox to pay a lower royalty than that which it clearly consented to when it adopted the SS agreement, but it is also inconsistent with the equal treatment that Penox has already been granted by receiving equal terms under the most favored licensee clause. Thus, since Penox has accepted the 5% or $15.00 (which ever is greater) license, which is *equivalent* to the provisions of the SS license, it should not be allowed to pay lower royalties than SS simply because the arbitrator dispensed his own form of justice by *rewriting* the agreement. As a result of the modification, Penox has an award which results in a 3.8% royalty (i.e. $15.00 for $397.05 chair) and SS pays a royalty of 17.3% (i.e. $15.00 for a base

sold for $86.81). Moreover, when SS sells a chair for $397.00 it will be a 5% royalty or $19.85 per chair. This result cannot be derived rationally from the agreement.

ARGUMENT

I. The arbitrator did not interpret the agreement, he amended the agreement.

The District Court ignored the precedents of this Court requiring that the essence of the award be found in the agreement itself. Although the District Court examined the appropriate authorities it did not follow the applicable law set forth therein. It is clear that the Court below considered the arbitrator's award to involve an interpretation of the agreement rather than a re-writing of the agreement App. 251, 254. In *Kane Gas Light & Heating v. Intern. Broth., etc.*, 687 F.2d 673 (3d Cir. 1982). This Court stated at page 678:

> "To be sure, there are limits to the deference accorded to the arbitrator's decision; the arbitrator may not simply "dispense his own brand of industrial justice," *Honold, supra,* 405 F.2d at 1125, quoting *United Steelworkers of America v. Enterprise Wheel and Car Corp.*, 363 U.S. 593, 597, 80 S.Ct. 1358, 1360, 4 L.Ed.2d 1424 (1965). Thus, if an arbitrator's award is made 'in *manifest disregard of the agreement, totally unsupported by principles of contract construction* and the law of the shop', 405 F.2d at 1128, the courts will not enforce the award. (footnote omitted) Otherwise, though, so long as the award "draws its essence from the collective bargaining agreement," *id.*, the courts will defer to the arbitrator's

> decision, a point which has been reaffirmed repeatedly by this court. See *Sun Petroleum Products Co. v. Oil, Chemical and Atomic Workers International Union, Local 8-901*, 681 F.2d 924 at 928 (3d Cir. 1982); *Mobil Oil Corp. v. Independent Oil Workers Union*, 679 F.2d 299 at 302 (3d Cir. 1982); *ARCO-Polymers, Inc. v. Local 8-74*, 671 F.2d 752, 755 (3d Cir. 1982) (per curiam). (emphasis supplied)

It is noted that the Third Circuit has held that some of the principles governing labor and commercial arbitration are similar but it is more difficult to overturn a labor case than a commercial arbitration case. *Swift Industries, Inc. v. Botany Industries, Inc.*, 466 F.2d 1125 (3d Cir. 1972).

It cannot be said that the arbitrator's award is a permissible interpretation of the agreement, where in complete disregard of the agreement, the arbitrator re-rewrote the royalty provisions.

The arbitrator's award is in part as follows:

> 1. ORTHOKINETICS, INC. and EDWARD J. GAFFNEY, hereinafter referred to as RESPONDENTS, shall pay to PENOX TECHNOLOGIES, INC., hereinafter referred to as CLAIMANT, the sum of THIRTY-TWO THOUSAND ONE HUNDRED TWENTY-THREE DOLLARS AND THIRTEEN CENTS ($32,123.13), plus interest at the rate of 6% percent per annum from January 28, 1988 to date of payment.
>
> 2. Under the "Most Favored Licensee" provision of the Agreement between the parties, CLAIMANT is entitled to pay 5% royalty on the net selling price of the *Mecha-*

nism Base or **Fifteen Dollars** ($15.00) whichever is greater from January 28, 1988. (App. 206)

The royalty provision in the original Penox license is as follows:

> *** which royalty shall be equal to five per cent (5%) of Penox's net selling price for such chair or $15.00 per chair, whichever is greater.

The royalty provision in the adopted Super Sagless license agreement provides as follows:

SUPER SAGLESS LICENSE

> *** Which royalty shall be equal to five per cent (5%) of SS's net selling price for such *chair* or $15.00 per chair, whichever is greater. (App. 140.)
>
> (arbitrator deleted chair and substituted mechanism base)

In making the award the arbitrator rewrote the Super Sagless royalty provision and made a new contract between the parties to require payment of a royalty of 5% or $15.00 only on the "Mechanism Base" and not 5% or $15.00 (whichever is greater) on the net selling price on the "entire chair" which includes a chair shell with a wooden frame and upholstery. The licensed patent claims under which Penox is operating relate to an entire chair rather than just a base mechanism. See claims 1, 7, 9, App. 122. All other licensees under this patent have a royalty provision of at least 5% per chair as well as a minimum of $15 to $25. (undisputed testimony of Gaffney). Because Penox sells only chairs at an average of $397.05 net selling price, as a result of the award, 5% or $15.00 per base mechanism, Penox is only paying a $15.00 royalty on the base mechanism part of the chair. The 5% royalty on a chair has been, in,

effect completely eliminated because bases cost Penox less than $100.00 and would sell for under $100.00.

Penox never made or sold bases but purchased the bases from a sub-contractor and assembled the bases with upholstered chair frames, made by Penox. Moreover, there is no "net selling price for bases" recovered by Penox from a sale of a chair. It is not separately invoiced to customers.

The 5% royalty in the Super Sagless Agreement, adopted by Penox, is to be applied to the "net selling price":

> 5. The term "net selling price" as used herein shall mean the selling price actually received by SS after deduction of sales taxes but without deduction of any commission, allowance or discount other than a discount ordinarily given. (App. 141)

As a result of the award, Penox has a better deal under the same royalty provision, than Super Sagless even though they are both operating under the identical contract clause.

RESULT OF ARBITRATION AWARD

PENOX

		Sales Price	**Royalty**
After Award	Chair	$397	$15.00
After Award	Chair Base*	Cost-$50.00	$15.00
Prior to Award	Chair	$397	$19.83 (5%)

**Penox did not sell bases at the time of arbitration hearing*

SUPER SAGLESS

	Sales Price	**Royalty**
Chair	$397	$19.85 (5%)
Chair Base	97	15.00

As is apparent from the above chart, based on the arbitrator's award under the same contract language, Penox pays the royalty of $15 per chair which sell for $397 and SS pays $15 per chair for a base that sells for $97. SS, however, would have to pay a royalty of 5% of $397 or $19.85 for a chair it sold at the net selling price of $397.00. The purpose of most favorable nation or licensee clauses is to grant an earlier licensee the same or more favorable *royalty terms* as a later licensee. The award does not do this and Penox clearly has an advantage over SS based on a selling price-royalty ratio. The royalty terms of the Penox and SS licenses are identical. Thus, the award goes beyond the intent of the parties in the original license between Penox and Orthokinetics to give equal royalty terms to all licensees. The arbitrator *rewrote* the royalty agreement to be 5% or $15 per *mechanism base*, rather than 5% of SS net selling price or $15 per *chair*, whichever is greater, App. 140. The award clearly exceeds the scope of the intent of the parties and is not rationally based on the Agreement. Consequently, the award should be vacated on this ground.

II. The arbitrator disregarded the unambiguous language, which constitutes amendment of the agreement and exceeds the arbitrator's authority.

The Court below erred because it did not recognize the limitations on the power of the arbitrator to construe, interpret or re-write the agreement other than that the result cannot be "Irrational". Add. 12, App. 256. The various precedents of this Court and others under 9 USC §10 have limited the arbitrator's power to interpret only ambiguous terms with no power to interpret non-ambiguous terms which constitutes rewriting of the agreement.

An Arbitrator is confined to interpretation and application of the agreement and does not sit to dispense his own form of justice. The award is legitimate only so long as it draws its essence from the agreement. When the award is not based on the agreement, the Courts have no choice but to refuse to enforce the award, *United Steelworkers of America v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 80 S.Ct. 1358 (1960).

The Third Circuit interpreted this Supreme Court decision as follows, at page 1128:

> "Accordingly, we hold that a labor arbitrator's award does 'draw its essence from the collective bargaining agreement' if the interpretation can in any *rational way be derived from the agreement, viewed in the light of its language, its context, and any other indicia of the parties' intention;* only where there is a manifest disregard of the agreement, totally unsupported by principles of contract construction and the law of the shop, may a reviewing court disturb the award." *Ludwig Honold Mfg. Co. v. Fletcher,* 405 F.2d 1123 (3d Cir. 1969). (emphasis supplied)

In *NF&M Corp. v. United Steelworkers of America,* 524 F.2d 756 (3d Cir. 1975), this Court stated:

> "If the arbitrator's award has deviated from the plain meaning of a labor contract provision, it must find support in the contract itself or in prior practices demonstrating relaxation of the literal language. *H.K. Porter Co., Inc. v. United Saw, File and Steel Products Workers of America,* 333 F.2d 596 (3d Cir. 1964)", at page 759.

In *Detroit Coil v. Intern. Ass'n of M. & A. Workers, etc.,* 594 F.2d 575 (6th Cir. 1979) the Court vacated the award under 9 USC §10(d). The Court said that a "word" in the

agreement which was in dispute had to be given the ordinary meaning and there was no evidence that the parties intended to deviate from that meaning. The Court held the arbitrator had exceeded his authority. The Court stated at page 579:

> "The arbitrator is confined to the interpretation and application of the collective bargaining agreement, and although he may construe ambiguous contract language, he is without authority to disregard or modify plain and unambiguous provisions."

Other cases which vacated the award where the arbitrator exceeded his power include *Monongahela Power Co. v. Local No. 2332, Intern. Bro.*, 566 F.2d 1196 (4th Cir. 1976) where the Court stated in referring to the arbitrator, at page 1199:

> "His function is confined to the interpretation and application of the collective bargaining agreement under which he acts and, while he may give his own construction to ambiguous language (footnote omitted), he is without any authority to disregard or modify plain and unambiguous provisions (footnote omitted). This is a well-established principle of the law; it is, also, specifically so provided in the agreement in this case (footnote omitted)."

In the case of *Inter-City Gas Corp. v. Boise Cascade Corp.*, 845 F.2d 184 (8th Cir. 1988), the Court reversed the District Court and vacated the arbitrator's award under 9 USC §10(d) because the arbitrator ignored the plain language of the contract. The Court held that the arbitrator exceeded his authority under the contract. The Court stated on page 187:

> "As the Supreme Court has stated in the labor context, '[t]he arbitrator may not ignore the plain language of the contract.' *United Paperworkers Int'l Union*, 108 S.Ct. at

> 371. More specifically, if the arbitrator interprets unambiguous language in any way different from its plain meaning, [the arbitrator] amends or alters the agreement and acts without authority. *District No. 72 & Local Lodge 1127, Int'l Assoc. of Mach. & Aerospace Workers v. Teter Tool & Die, Inc.*, 630 F.Supp. 732, 736 (N. D. Ind. 1986) (labor arbitration). Thus, we will review the arbitration award to ensure it is grounded on the parties contract."

The rewriting of non-ambiguous terms of an agreement by an arbitrator does not constitute a permissible interpretation of the agreement. The Court below erred in ignoring the limitation on the power of arbitrators in commercial arbitration cases.

Penox may have acquired the right to make bases as well as chairs by adopting the SS agreement. The Penox agreement, however, limited Penox to making only chairs. The original Penox license provides in part

> *** This license is limited to reclining elevator chair mechanism designs which PENOX is currently manufacturing or assembling (App. 126).

However, Penox had chosen not to make bases. Penox has made the choice to make chairs, not bases, and should pay the same royalty for chairs as SS pays for chairs, 5% or $15.00, whichever is greater.

The license provisions in both the Penox and Super Sagless licenses establish a royalty *floor* assuring the licensor ORTHOKINETICS receipt of a *minimum* of $15 for each licensed sale, regardless of the sales price or nature of article sold. These provisions are commonplace in patent licensing.

The patent claims (Exhibit 4, pages 122-123) all apply to an entire chair and *Orthokinetics is entitled to a royalty on the*

entire chair under the license as if it had obtained a judgment for damages. The entire market value rule allows for the recovery of damages based upon the value of the entire chair. *TWM Mfg. Co. Inc. v. Dura Corp.*, 789 F.2d 895, 901 (Fed.Cir. 1986). If Orthokinetics had pursued the infringement suit to judgment it would have been entitled to as a minimum, a reasonable royalty pursuant to 35 USC 284 on the entire chair rather than merely the base. Penox agreed to pay a 5% royalty on an entire chair. So did Super Sagless. It makes no sense to limit the scope of the patent to only require the licensee Penox to pay a royalty on only a chair base for immunity from suit after Orthokinetics went to the expense of suit to stop an infringement. This is contrary to the intent of the parties. Penox agreed to 5% on all chairs after the date of settlement, App. 169. Orthokinetics did not agree in either the Penox or SS licenses to receive only royalties on the chair base where complete chairs are sold by the licensee.

In The Matter of *Board of Education of North Babylon Union Free School District v. North Babylon Teachers' Organization*, 479 N.Y.S. 2d 536 (A.D. 2.Dept. 1984). The Court vacated the arbitrator's award because it went beyond the contract. The Court stated as follows:

> "The arbitration award challenged in the instant proceeding is analogous to that encountered in *County of Ontario v. Civil Serv. Employees Ass'n., Ontario County Chapter*, 76 Misc.2d 365, 351 N.Y.S.2d 101, Aff'd. 46 A.D.2d 738, 361 N.Y.S.2d 1021, which the court vacated pursuant to CPLR 7511 (subd.[b], par.1, cl. [iii], after concluding that the arbitrator exceeded his powers when he "modified the contract by including a provision adding to its terms and in effect he made a new contract for the parties . . . In making the award he did not draw

his conclusion from the agreement itself but went beyond the contract. This was not a mere error of judgment, either as to fact or law, but the clear case of an arbitrator rewriting the contract to the prejudice of the petitioner and the court must refuse to enforce the award" (*County of Ontario v. Civ. Serv. Employees Ass'n, Ontario County Chapter, supra,* 76 Misc.2d pp. 367-368, 351 N.Y.S.2d 101).

The legal authorities submitted herein preclude any action by the arbitrator in changing the negotiated royalty rates in the Super Sagless agreement.

The arbitrator is only empowered to uphold the parties' agreement. The arbitrator has no equitable powers to *re-write* the royalty rate. In *OEHMKE Commercial Arbitration,* published 1987 by Lawyers Cooperative Publishing, Page 312, the author states:

> "**Court of equity.** An arbitrator does not sit as a "court of equity". An arbitrator's power is derived from the contract, not equity. Though arbitrators may grant equitable kinds of relief (e.g. injunction, specific performance, etc.), ". . . the arbitrator is not a chancellor and possesses no equitable powers except as the submission may expressly grant such powers." *Carr v. Kalamazoo Vegetable Parchment Co.,* 354 Mich 327, 92 NW2d 295 (1958). The arbitrator must abide by the standards set forth by the parties."

In the arbitration clause of the Penox or Super Sagless agreement, there is no power granted to the arbitrator allowing him to re-write the rates. Just as a court cannot, under the guise of construction, modify or create a new contract, an arbitrator cannot, under the guise of construction, create a

new contract. This is well established. In 17 AmJur2d Section 242 Contracts, the following appears:

> "It is a fundamental principle that a court may not make a new contract for the parties or rewrite their contract under the guise of construction. In other words, the interpretation or construction of a contract does not include its modification or the creation of a new or different one. It must be construed and enforced according to the terms employed, and a court has no right to interpret the agreement as meaning something different from what the parties intended as expressed by the language they saw fit to employ. A court is not at liberty to revise, modify, or distort an agreement while professing to construe it, and has no right to make a different contract from that actually entered into by the parties. Courts cannot make for the parties better or more equitable agreements than they themselves have been satisfied to make, or rewrite contracts because they operate harshly or inequitably as to one of the parties, or alter them for the benefit of one party and to the detriment of the other, or, by construction, relieve one of the parties from terms which he voluntarily consented to, or impose on him those which he did not."

III. Penox is not entitled to pay the same royalty for its chair as SS, the subcontractor pays for its base.

A patentee can exact royalties from different levels in the manufacture of a product. In addition, a patentee can collect different royalties from contributory infringers and direct infringers. The royalty provisions in the Penox and SS licenses

are consistent with how patent law treats contributory infringers and direct infringers and also the intent of the parties to those agreements.

The patent infringement statutes Title 35, Section 271 defines various categories of infringers in 271(a); direct infringers; and 271(c) contributory infringers. In the facts in this case, if Super Sagless did not have a license it would be a contributory infringer because it makes and sells only the base, only a part of the elements covered. In an infringement suit the reasonable royalty it would collect from a sub-contractor would be different that it would collect from a manufacturer who sells the complete chair. The reasonable royalty test for damages applied to a subcontractor and to a manufacturer of an entire chair would provide different reasonable royalties. The reasonable royalty analysis is based on a hypothetical licensing negotiation between a willing licensor and a willing licensee and determines, based upon this, what reasonable royalty would have been agreed to. *Stickle v. Heublein, Inc.*, 716 F.2d 1550, 1561 (Fed. Cir. 1983).

In *Georgia Pacific Corp. v. United States Plywood Corp.*, 318 F.Supp. 1116 (S.D.NY. 1970), modified and affirmed *sub nom. Georgia Pacific Corp. v. U.S. Plywood-Champion Papers, Inc.*, 446 F.2d 295 (2nd Cir.), *cert. denied*, 404 U.S. 870 (1971), fifteen evidentiary factors are listed that are relevant to the determination of a reasonable royalty. The Federal Circuit has approved the law in this case.

Typically, in a willing licensor-licensee situation, a licensee will not pay more than one-fourth to one-third of his profit as a royalty. Thus a base maker who has a smaller profit on the sale of a base at $95.00 than a manufacturer who sells the entire chair at $400.00 will not be willing to pay as high a royalty as the chair maker. Yet in this case Penox wants to pay

the same lower royalty as a sub-contractor. The charts, addendum pages 17 and 18, demonstrate the higher profit of Penox than SS and Mississippi Medical, the purchaser from SS. It is apparent that Penox has the better deal than SS, which pays a royalty of $15.00 on the base it sells for $86.00 equivalent to a 17% royalty (these charts were before the Court below). It is apparent from the foregoing that the award is not rationally based on the agreement, or the intent of the parties or common sense. If Penox wants a $15.00 royalty it can operate as a sub-contractor and make bases rather than chairs. Percentage royalties are recognized as the fairest arrangement between patentees and infringers. In this case the arbitrator has effectively eliminated the percentage royalty for the chair from the agreement.

IV. The arbitration award based on the lack of power of the arbitrator is subject to being vacated under the Federal Arbitration Act.

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9 U.S.C. §10(d) provides as follows:

10. **Same; vacation; grounds; rehearing**

In either of the following cases the United States court in and for this District wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

(a) Where the award was procured by corruption, fraud, or undue means.

(b) Where there was evident partiality or corruption in the arbitrators, or either of them.

(c) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause

shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(d) *Where the arbitrators exceeded their powers,* or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

(e) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators. (emphasis supplied)

The Federal Statute is based on the New York statute and New York cases are of interest in applying the New York Statute. See *The Hartbridge Case,* 57 F.2d 672 (1932, CA2, NY). In *Swift Industries, Inc. v. Botany Industries, Inc.,* 466 F.2d 1125 (3d Cir. 1972), the Third Circuit considered New York arbitration cases as relevant law.

Pertaining to vacating or modifying an arbitration award, the New York statute states that grounds for vacating an award include instances when "an arbitrator, or agency or person making the award exceeded his power or so imperfectly executed it that a final and definite award upon the subject matter submitted was not made" (CPLR §7511(b)(iii)).

The current New York case law which interprets "exceeded his power", is based on *Lentine v. Fundaro,* 328 NYS2d 418 (1972), which is applied in the cases that followed *Fundaro.* In *Civil Serv. Emp. Ass'n v. County of Steuben,* 377 NYS2d 849 (1976), the Court stated at page 853, 854, in holding that the arbitrator exceeded his power by writing a new contract for the parties:

"There are two basic factors which have been considered in determining whether an arbitrator acted in excess of his power. First, was the construction given the contract document by the arbitrator completely irrational (*Lentine v. Fundaro, supra,* p.385, 328 NYS2d pp. 421-422, 278 NE2d p.635; *Matter of National Cash Register Co.[Wilson]*, 8 NY2d 377, 383, 208 NYS2d 951, 955-956, 171 NE2d 302, 305) and, second, did the contract agreement itself expressly limit the power of the arbitrator (*Lentine v. Fundaro, supra*, 29 NY2d pp. 385-386, 328 NYS2d pp. 421-423, 278 NE2d pp. 635-636; *Matter of Granite Worsted Mills [Cowen], supra*, 25 NY2d pp. 456-457, 306 NYS2d pp. 938-939, 255 NE2d pp. 170-171)? In effect, the question can be stated as follows: Did the arbitrator merely interpret the existing Agreement or did he, in fact create a new contract (*Matter of National Cash Register Co. [Wilson], supra*, 8 NY2d p. 383, 208 NYS2d pp. 955-956, 171 NE2d p. 305)?"

In *Simpson v. North Collins Central School Dist.*, 392 NYS2d 107 (1977), the court, in reversing the award of an arbitrator, stated at page 110:

"We conclude that the arbitrator's imposition of *ex post facto* procedural standards for the evaluation of the grievants was tantamount to the making of a new contract for the parties, and was therefore in excess of his powers."

In *The Roosevelt Hospital v. Dennis M. Silverman, etc.*, 392 NYS2d 580 (1977), the Court commented at page 580:

"In these circumstances, an award requiring the employer to pay the grievant employees under the clause forbidding sub-contracting of bargaining unit work means that the Arbitrator 'gave a completely irrational construction to the provisions in dispute and, in effect,

made a new contract for the parties.*** The arbitrator therefor 'exceeded his power' withia the meaning of CPLR §7511(b)1(iii) and *Matter of National Cash Register Co. [Wilson], supra.*"

CONCLUSION

The arbitrator's award changing the royalty rate from the net selling price of the chair to the net selling price of the mechanism base and awarding $32,123.13 to Penox based on the rewritten royalty provision is without basis in the license, the intent of the parties or contract law. The royalty provision is not ambiguous and there is no rule of contract construction which would permit the change in the contract made by the arbitrator. As a result of the award, Penox can sell a chair for $400.00 and pay a royalty of $15.00 on the base for the chair and pay nothing for the chair shell. SS, an the other hand, will be required to pay a royalty on the entire chair, i.e., 5% or $15.00, whichever is greater which would be $20.00 on a $400.00 chair. This was not the intent of the most favored nation clause.

This Court can make disposition of the royalty issue without remand. *First Nat'l Bank v. Lincoln National Life Ins. Co.*, 824 F.2d 277, 281-82 (3d Cir. 1987).

For the foregoing reasons this Court should vacate the award pursuant to 9 USC Section 10 and conclude that the arbitrator had no authority to change the royalty provisions and set aside the monetary award.

DATED this day of June, 1989,

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By

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